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No. 10-693

Supreme Court, U.S.
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In the
Supreme Court of the United States

ERNST & YOUNG LLP, et al.,

Petitioners,

v.

SHARON P. CLARK,
Commissioner for the Kentucky Department of Insurance and Rehabilitator of AIK Comp, et al.,

Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of Kentucky

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

This Court should grant certiorari here because (1) the Kentucky Supreme Court's expansive interpretation of the McCarran-Ferguson Act conflicts with *Department of Treasury v. Fabe*, 508 U.S. 491 (1993), and *AmSouth Bank v. Dale*, 386 F.3d 763 (6th Cir. 2004); (2) the question presented is important to anyone who deals with insurance companies and would like to insist on the federal right to arbitrate, including auditors, for whom access to arbitration is critical; and (3) this is an ideal vehicle because the McCarran-Ferguson Act is the sole reason Petitioners ("Ernst & Young") were unable to compel arbitration. By compelling arbitration of the parallel members' class action that did not implicate McCarran-Ferguson, the Kentucky Supreme Court made clear that, but for reverse preemption, arbitration would be required here as well.

The Brief in Opposition confirms many of these points. Respondent does not dispute that the question presented is an "important public matte[r]." Opp. 7. Indeed, she inadvertently underscores the importance of obtaining a hearing in a neutral tribunal. Respondent emphasizes that a state jury trial presents a risk of a runaway verdict that "arbitration cannot match" and that a state-court trial would expose Ernst & Young to public shame. Opp. 25–27. Respondent also admits that "the McCarran-Ferguson reverse-preemption issue" was dispositive and that no adequate or independent state ground bars review. Opp. 33.

Respondent's opposition to certiorari thus hangs on convincing this Court (1) that the conflicts with *AmSouth* and *Fabe* are not square; or (2) that this is a poor vehicle. Respondent is wrong on both fronts.

I. THE DECISION BELOW CONFLICTS WITH *AMSOUTH* AND *FABE*

A. There Is Nothing Special About Audits or "Self-Insurance Groups"

Respondent repeatedly denies that this is a "garden-variety" tort suit and argues instead that choice of forum here is unusually linked to the "business of insurance" because (1) AIK Comp ("AIK") was a "self-insurance group"; and (2) this case involves audits that were required by Kentucky's Insurance Code. *E.g.*, Opp. 9, 11–13, 19, 30, 32. But "the focus" of the McCarran-Ferguson Act is the relationship between policyholders and insurers, *Fabe*, 508 U.S. at 501, and the fact that this suit involves audits of a "self-insurance group" has no bearing on that relationship. This suit is as garden-variety as they come.

1. It is irrelevant that AIK is a self-insurance group. Even Respondent would concede that a self-insurance group's dispute over "office supplies" would qualify as "garden-variety," Opp. 19, implicating the split between *AmSouth* and *Davister Corp. v. United Republic Life Ins. Co.*, 152 F.3d 1277 (10th Cir. 1998). Audit services are no different. If anything, the fact that AIK is a self-insurance group makes the choice of forum *less*, not more, relevant, to policyholders. Unlike policyholders of an ordinary insolvent insurance company, AIK's members do not face the

prospect of losing coverage, but simply must make up for paying artificially low premiums in the past.

The root of AIK's insolvency was that it charged premiums that were too low. Opp. 44b–45b. As a self-insurance group with all members jointly and severally liable for any liabilities, AIK's members were charged assessments to make up the shortfall (and could be further assessed in the future). Pet. App. 6–7. As a result, claims will be paid and AIK's policyholders will have paid the proper amount for coverage; policyholders simply will have paid some premiums later rather than sooner.

To be sure, if a state-law forum proves outcome-determinative, the result will improve AIK's bottom line and indirectly benefit members. But if anything, that is more true of policyholders of an ordinary insurer who might regain coverage they otherwise would have lost. In any event, *Fabe* holds that such generalized effects on an insurer's bottom line are insufficient to trigger reverse preemption. 508 U.S. at 508–09. AIK's form cannot change that fundamental rule, otherwise every activity of a self-insurance group — even purchasing office supplies — would constitute the "business of insurance."

2. It is also immaterial that Kentucky law required AIK to obtain and file an audit with a state official. Ky. Rev. Stat. Ann. § 342.347(1) (2001).[1] While policyholders might care *whether* their

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[1] Respondent misleadingly implies that this section "created duties or liabilities" upon auditors. Opp. 11. It imposed a filing requirement on insurers, not auditors. § 342.347(1).

insurer's accounting statements are audited, they surely do not care *why* the insurer obtained the audit. *See Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 132 (1982).

And contrary to Respondent's assertions, Opp. 5, 30, state-court control over auditing disputes is not "integral" to Kentucky's regulatory scheme, much less the policyholder-insurer relationship. If it were, Kentucky and other states would insist on a state-court forum for all insurer-auditor disputes (without regard to delinquency), just as they ban arbitration of all insurer-policyholder disputes over coverage (without regard to delinquency). Ky. Rev. Stat. Ann. § 417.050(2); *e.g.*, Mo. Rev. Stat. § 435.350; Kan. Stat. Ann. § 5-401(c). But Kentucky has done no such thing and, to Petitioners' knowledge, no other state has either. Kentucky insists on a state-law forum for *any* third-party dispute — and only when there is a delinquency. Ky. Rev. Stat. Ann. § 304.33-040(3)(a). The statute reflects no special solicitude for the auditor-insurer relationship. It reflects a generic interest in establishing procedures for resolving the delinquency of an insurance company. Under *Fabe*, such a generic interest is insufficient. 508 U.S. at 508–09.

The allegation that Ernst & Young "contributed" to AIK's demise also does not trigger reverse preemption. Opp. 27. A "contribution" rule would render the McCarran-Ferguson Act virtually limitless, as any business decision that resulted in losses will have "contributed" to insolvent insurer's demise. This Court has repeatedly rejected such an expansive vision of reverse preemption. *See Fabe*,

508 U.S. at 508. The statute "exempts the 'business of insurance' and not the 'business of insurance companies.'" *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 217 (1979).

B. The Conflict with *AmSouth* Is Square

Respondent does not deny that there is a split between *AmSouth* and *Davister*. Respondent contends, however, that *AmSouth* is distinguishable from this case because it involved (1) the diversity jurisdiction statute, not the Federal Arbitration Act ("FAA"), 9 U.S.C. § 2; (2) an exclusive-jurisdiction state-court injunction, not an exclusive-jurisdiction state statute; and (3) a declaratory judgment action, not a suit for damages. Opp. 8–9.[2] But *AmSouth* itself confirms that these factors are immaterial. *See* Pet. 27–28.

1. In *AmSouth*, the Sixth Circuit found cases to be on point irrespective of these minor differences. First, the court found irrelevant whether the third-party sought refuge in a federal court or an arbitral tribunal; it treated as fungible the forum in *AmSouth*, a diversity suit, and *Davister*, *Munich Am. Reins. Co. v. Crawford*, 141 F.3d 585 (5th Cir. 1998), and *Stephens v. Am. Int'l Ins. Co.*, 66 F.3d 41 (2d Cir. 1995), which are FAA suits. *AmSouth*, 386 F.3d at 781–72. Second, the court found irrelevant whether exclusive state-court jurisdiction was

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[2] Respondent also notes that this case involves state-required audits for a "self-insurance group," while *AmSouth* involved banking services for a traditional insurer. Opp. 9. As *supra* Part I.A shows, these are distinctions without a difference.

required by an injunction or a statute; it viewed the injunctions in *AmSouth* and *Munich* as fungible with the statutes in *Davister* and *Stephens*. *Id.* Third, it found irrelevant whether the insurer initiated suit offensively or the putative tortfeasor did defensively; it treated the declaratory-judgment posture of *AmSouth* as parallel to *Gross v. Weingarten*, 217 F.3d 208 (4th Cir. 2000), and other insurer suits for damages. *AmSouth*, 386 F.3d. at 782–73.

AmSouth ultimately held that barring a neutral forum from adjudicating an "ordinary suit" between an insolvent insurer and a third-party tortfeasor "implicates a 'regulation of the business of insurance' only in the attenuated fashion rejected in *Fabe*." *Id.* at 783. That rule is correct and, as the Sixth Circuit' recognized, does not depend on whether (1) the neutral forum is a federal court or an arbitral tribunal; (2) the exclusive-jurisdiction rule appears in a statute or an injunction; or (3) the suit is for damages or a declaratory judgment. If the Kentucky Supreme Court had applied the Sixth Circuit's rule, it would have reversed, not affirmed. That is the definition of a conflict under Rule 10.

2. *AmSouth* was correct to reject these distinctions. First, with respect to reverse preemption of a state exclusive-jurisdiction provision, the FAA and the diversity-jurisdiction statute are analytically identical. Neither law "specifically relates" to insurance. 15 U.S.C. § 1012(b). And both guarantee access to a non-state-court forum. Therefore, both preempt state exclusive-jurisdiction provisions in the exact same way. Second, there is no functional difference between an injunction

prohibiting access to any other forum and a statute imposing exactly the same prohibition — especially where the injunction flows from a state statute.[3] Third, it would be nonsensical to allow Ernst & Young to arbitrate a declaratory action evaluating whether it has valid defenses to Respondent's claims, but not to arbitrate whether those same defenses are valid against the same claims when brought in an action for damages. The two postures are flip sides of the same coin and implicate policyholders' interests only in the same "attenuated fashion." *AmSouth*, 386 F.3d at 783.

3. While *Munich* and *Stephens* reflect the general disarray in the lower courts, they do not support Respondent. As the Petition explained, those cases involve a different question. Pet. 30–32. *AmSouth*, *Davister*, and this case involve ordinary tort suits against a third party outside the insurance industry. *Munich* and *Stephens* involve coverage disputes between an insurer and a reinsurer. *Munich*, 141 F.3d at 587–88; *Stephens*, 66 F.3d at 42. Coverage disputes directly impact policyholding insurers and reinsurance is "'limited to entities within the insurance industry.'" Pet. 30–31 (quoting

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[3] Respondent misleadingly suggests that the antisuit injunctions in *AmSouth* were not entered pursuant to a state liquidation law. Opp. 10. The injunctions in *AmSouth* were entered pursuant to Miss. Code Ann. § 83-24-47(1), Mo. Rev. Stat. § 375.1188(1), and Okla. Stat. tit. 36, § 1904(B), which are modeled on the Uniform Insurers Liquidation Act. Brief of Appellants at 8, *AmSouth*, 2003 WL 24309280.

Pireno, 458 U.S. at 129). "The nexus to the 'business of insurance' is thus substantially tighter." *Id.*[4]

Respondent is also doubly wrong to argue that barring arbitration here spreads risks by "introducing the possibility of jury verdicts into the process for resolving disputed claims." Opp. 26 (quoting *Standard Sec. Life Ins. Co. v. West*, 267 F.3d 821, 824 (8th Cir. 2001) (per curiam)). First, unlike *West*, this suit does not remotely involve "the process for resolving disputed *claims*," *i.e.*, claims for insurance coverage. *West*, 267 F.3d at 822; *see* Pet. 22, 30–31. It involves a tort suit by an insurer against a third party. Second, and more fundamentally, insurance is about spreading pre-existing risks — not creating new risks for anyone who does business with an insurance company.

Respondent also seeks false comfort in this Court's denials of certiorari in *Davister* and *Munich*. Opp. 6–7. *Munich* is distinguishable, and both cases were decided before *AmSouth*, and thus there was no split at the time. No petition for certiorari was filed in *AmSouth*. Thus, this Court's prior treatment of this issue was consistent with Rule 10's criteria. Those same criteria support certiorari here to review an important federal question on which the lower courts are now split.

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[4] *Stephens* highlights an unfairness of Kentucky's exclusive-jurisdiction provision: It prevents third-party defendants from litigating anywhere but Kentucky state court — but allows the rehabilitator to sue even in the Second Circuit.

C. The Conflict with *Fabe* is Square

1. Respondent denies that the Kentucky Supreme Court assessed the purpose of Kentucky's arbitration ban by looking to the purpose of the IRLL "as a whole," rather than applying the subsection-by-subsection approach *Fabe* commands. Opp. 19–21. But Respondent relies entirely on quotations taken out of context.

The Kentucky Supreme Court's analysis of the purpose prong is so simplistic that it fits in a single paragraph. Pet. App. 10–11. Respondent ignores this paragraph and instead relies upon passages discussing McCarran-Ferguson Act's third prong: whether the FAA conflicts with the exclusive-jurisdiction provision. *Compare* Opp. 19–21 (citing Pet. App. 17–19), *with* Pet. App. 17–19. But under *Fabe*, any conflict at all is not enough; the provision at issue must also be aimed at "regulating the business of insurance." In only reviewing the purpose of the IRLL as a whole, the Kentucky Supreme Court never meaningfully addressed this question — and fundamentally missed *Fabe*'s point.

2. The Kentucky Supreme Court's decision also conflicts with *Fabe* in holding that the McCarran-Ferguson Act extends to this proceeding. Respondent seeks to distinguish *Fabe*'s bottom line, but she essentially rehashes her earlier arguments: that (1) *Fabe* is not an FAA case, it is only about claim priority; and (2) the impact on policyholders is not attenuated because AIK is a "self-insurance group" and the suit involves audits. Opp. 14, 22–23. Not even the Kentucky Supreme Court believed that *Fabe*

was limited to the claims-priority context. Pet. App. 11. And the self-insurance and audit-requirements distinctions are red herrings. *Supra* Part I.A.

The conflict with *Fabe* is therefore square. *Fabe* held that generalized rules manipulating the claim priority process to benefit an insolvent insurer are unprotected because the impact on the policyholder-insurer relationship is too attenuated to constitute regulation of the "business of insurance." 508 U.S. at 508–09. The same is true for Kentucky's generalized and "extremely broad" rule granting exclusive jurisdiction over "all matters in any way relating to any delinquency" — including garden-variety tort claims. Pet. App. 14. Such a rule might benefit an insurer's bottom line (at the expense of every policy embraced by the FAA), but such an indirect impact on policyholders is too attenuated to trigger reverse preemption.

II. THIS IS AN IDEAL VEHICLE

1. Respondent half-heartedly argues that this vehicle is subpar because, on remand, the Kentucky Supreme Court could affirm on alternative state-law grounds. Opp. 32–36. But Respondent admits that "the McCarran-Ferguson reverse-preemption issue" was outcome-determinative and that no adequate or independent state ground bars review. Opp. 33. There is therefore no vehicle problem.[5]

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[5] Respondent also suggests that Ernst & Young's *Fabe* argument is not preserved. Opp. 14. But Ernst & Young presented *Fabe* to the Kentucky Supreme Court, Respondent

Respondent's alternative state-law argument is also meritless. Respondent asserts that AIK's arbitration clause is unenforceable against her because, as Rehabilitator, she did not sign it. Opp. 34. But Respondent can only sue Petitioners by stepping into AIK's shoes: Respondent's suit is "on behalf of [AIK]" and raises "causes of action that [AIK] could have maintained in its own name." Opp. 42b–43b. Respondent cannot step into AIK's shoes to bring a claim and then pretend to be a stranger to AIK's arbitration clause. Indeed, the Kentucky Supreme Court rejected a virtually identical argument below. It held that AIK's arbitration clause bound the class members' derivative claims — even though they did not sign it either. Pet. App. 23.

2. The Kentucky Supreme Court's decision to compel arbitration of the members' class action makes this vehicle even cleaner. The arbitration clause is indisputably valid — the Kentucky Supreme Court enforced it. And the only reason it declined to compel arbitration of Respondent's claims was because it held that the McCarran-Ferguson Act shielded them. Pet. App. 22. But for the Kentucky Supreme Court's interpretation of the McCarran-Ferguson Act, the FAA would command arbitration here as well.

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engaged on the issue, and that court did not apply a procedural bar; it rejected Ernst & Young's argument on the merits. *See* Pet. 10–13. That is more than enough to preserve the issue. *Cone v. Bell*, 129 S. Ct. 1769, 1782 (2009) (this Court will not "apply state procedural bars where state courts have themselves declined to do so").

3. The need for review here is also particularly pressing because Respondent and the state courts embrace the "hostility to arbitration that Congress intended the FAA to override." Pet. 34. Indeed, Respondent amplifies the rhetoric by emphasizing that arbitration must be prohibited to expose Ernst & Young to a heightened risk of a runaway jury verdict — and to public shame in the process. Opp. 25–27.

Congress and this Court have rejected this anti-arbitration prejudice by creating and vigorously enforcing the FAA's guarantee of access to arbitration. As *amicus* Center for Audit Quality illustrates, arbitration is "often far superior" for resolving auditing disputes, as appropriate damages are generally awarded when — but only when — a deficient audit causes injury. CAQ Br. 10. Ernst & Young accordingly insisted on arbitration and AIK agreed. The Kentucky Supreme Court correctly recognized that the FAA requires arbitration of the members' claims. But it rendered that a hollow victory (and thwarted the FAA's goals) by allowing the Rehabilitator's strikingly similar suit — seeking similar damages based on the same derivative negligence claims relating to the same audits — to avoid arbitration.

It is critical to auditors and others who choose arbitration when doing business with insurance companies that their choice be honored. Otherwise, as here, they face being dragged before hostile courts in an avowed effort by a state official to take advantage of the state jury system. Ernst & Young would not have audited AIK absent its federally-

protected agreement to arbitrate disputes in a neutral forum.

The Kentucky Supreme Court's decision exposes Ernst & Young to precisely the risk that the FAA protects against. That court held that the FAA was trumped by Kentucky's "extremely broad" exclusive-jurisdiction provision — a provision that applies only in liquidation. The court below did all this even though choice of forum over Respondent's suit impacts policyholders, if at all, only in the extraordinary attenuated manner *Fabe* rejected. That holding conflicts with this Court's precedents and *AmSouth* and warrants certiorari.

CONCLUSION

For the foregoing reasons, this Court should grant the petition for certiorari.

RESPECTFULLY SUBMITTED

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